Attachment 1

WILSHIRE
CONSULTING

Rosalind M. Hewsenian
Managing Director

July 20, 2006

Mr. Russell Read, PhD, CFA
Chief Investment Officer
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Corporate Governance Co-Investment Strategy

Dear Russell,

You had requested Wilshire's opinion regarding Staff's desire to expand the corporate governance co-investment program with respect to delegated authority to the Global Equity SIO, policy changes and the addition of a new staff member. If approved four additional corporate governance managers: SPARX, Shamrock, Hermes European Focus Fund and Taiyo Pacific Partners would join Relational and Knight Vinke as potential sources of investment opportunities. Wilshire is supportive of these changes.

Discussion

Staff and Wilshire have been working on this concept of expanding the co-investment program for corporate governance for more than a year. The performance results of the entire corporate governance program speak to its success and Wilshire believes that Staff's request for expanded delegated authority, its proposed criteria for selecting new managers for inclusion in the program and seeking an additional portfolio manager are prudent and necessary.

<u>Delegated Authority</u>. The importance of delegating the investment decisions to the Global Equity SIO lies in the impact of entry point on total return. Wilshire spends a lot of time in its due diligence efforts with the corporate governance managers exploring how they determine the timing of their entry point into a target investment: enter too early, the overall net return can be impeded; enter too late, and the same outcome can occur. By delegating the decision to the Staff, entry and exit points can be managed more precisely than if a month was lost waiting for the action to be taken to the Investment Committee. Given the market's recently volatility for example, trading opportunities that are hampered by the timing of Investment Committee meetings could cause CalPERS to miss a more opportune trading environment.

The corporate governance co-investment delegation request is materially consistent with the Staff co-investment delegation applied to the AIM Program. However, the increased liquidity of corporate governance investments compared to AIM investments makes this delegation of authority less risky for the Investment Committee.

Policy Change to Expand the Number of Eligible Managers. Though successful thus far, the co-investment program is currently extremely concentrated. While this concentration is an element in the program's success, the narrowness of the list of eligible deal sources (the approved managers) actually increases the risk of the program because it is so constrained.

The criteria for the inclusion of a new manager in the program are reasonable. Since this is still a new area of investment and in many cases CalPERS is putting the managers into business, the one-year time frame of experience may seem short, but given the fact that the average age of the managers in the Corporate Governance Program is about 3 years, the one-year timeframe of experience with CalPERS is proportional. The performance criterion of exceeding the benchmark is also reasonable. Though the time period of performance observation is short, the criterion is directionally correct. The risk of the short length of the performance record on which to base a manager's inclusion can easily be borne by CalPERS. A large portion of the global equity assets is allocated to index funds, which are diversifying, and the dollar limit allocated to each co-investment, relative to the total Global Equity assets, is very small. The corporate governance co-investment policy would have to be amended to implement Staff's recommendation and brought back to the Investment Policy Sub-Committee for approval. If approved four additional corporate governance managers: SPARX, Shamrock, Hermes European Focus Fund and Taiyo Pacific Partners would join Relational and Knight Vinke as potential sources of investment opportunities.

Adding additional Staff is prudent and far less expensive than if additional assets were simply given to the money manager: the action would pay for itself. Additional staff would ensure the proper analysis and monitoring of the co-investments.

Should you have any questions or require anything further, do not hesitate to contact us.

Sincerely,